



Memorandum

To : Mr. Verne Walton

Date: September 23, 1988

From : Robert R. Keeling

Subject: Real Property Acquired by Public Retirement Systems; Assessors' Letter 83/03

This is in response to your memorandum dated April 11, 1988. You ask for our opinion of the proper method of assessment of public retirement system properties purchased for investment income that are to be assessed in accord with Government Code section 7510. You also ask that we look at Assessors' Letter 83/03 in light of Chief Counsel James Delaney's memo of December 19, 1983.

Government Code section 7510 provides in pertinent part that when a public retirement system invests assets in real property for the production of income, then it shall pay annually to the city or county, in whose jurisdiction the real property is located and has been removed from the secured roll, "a fee for general government services equal to the difference between the amount that would have accrued as real property secured taxes and the amount of possessory interest unsecured taxes paid for that property". Government Code section 7510 by its terms does not apply to investment property of any retirement system which was established by a local government entity and was authorized to invest in real property as of the time Government Code section 7510 was enacted.

Section 7510 was added to the Government Code by chapter 24 of the Statutes of 1982. The addition was part of an enactment which added a provision to the Education Code to permit the teachers retirement board to invest funds in real property and improvements thereon, such property to be used for business or residential purposes. The Legislature apparently saw the need to prevent such investments from reducing local taxes while at the same time including a provision to excuse any retirement system which had theretofore been authorized to make such investments.

As far as I can discover, government, both state and local, have no authority to create a retirement plan except as statutorily provided. Retirement systems created by such statutory authority necessarily become instrumentalities of the

state or local government that creates the system. (See Housing Authority v. Dockweiler, 14 Cal.2d 437, 441, a housing authority created by Department of Interior is declared to be an instrumentality of the United States; Alward v. Johnson, Treasurer, State of California, 208 Cal.359, a private party engaged by contract to deliver mail does not become an instrumentality of the government such that his personal property is exempt from state taxation; Western Lithograph Company v. State Board of Equalization, 11 Cal.2d 156, the court assumed a national bank is an instrumentality of the United States as contemplated by McCulloch v. Maryland, 4 Wheat 316 (4 L. Ed. 579)).

Property purchased by government instrumentalities is exempt from taxation under California Constitution article XIII, section 3 except as provided under California Constitution article XIII, section 11. Taxation of government-owned property is permitted under section 11 only when the property is taxable when purchased and located outside the boundaries of the entity owning the property. Those boundaries with respect to retirement system properties would be the boundaries of the government creating the retirement system. If the government creating the property were a county then the boundary would be the boundary of the county. Likewise, if the creating government were a city the boundaries would be that of the city; and if a district, the boundaries would be that of the district; and if the State of California, the boundaries would be that of the state.

The overlapping mandates of California Constitution article XIII, section 3 (exempting taxation of government property), California Constitution article XIII, section 11 (allowing property taxation of certain government-owned property located outside governmental boundaries), Revenue and Taxation Code section 107 (defining and permitting taxation of possessory interest), and Government Code 7510 (permitting levy of fee in-lieu of taxation of retirement system properties) all must be reconciled when establishing a policy for the assessment of retirement system properties.

We will proceed now to illustrate our view of the proper assessment methods for the different situations that may be encountered. The situations will differ depending upon whether the property is inside or outside the boundaries and whether the property is used by the retirement system or whether it is an investment owned by the system.

The first situation is when the property is owned and used by the retirement system for the operational business of the retirement system. If that property is within the boundaries

of the government creating the retirement system, then the property is exempt from taxation under California Constitution article XIII, section 3, and California Constitution article XIII, section 11, is inapplicable. If, on the other hand, such property is outside the boundaries of the government creating the retirement system and was taxable when acquired, then the property, whether owned by the system for its own use or owned by the system for investment property, is subject to assessment under California Constitution, article XIII, section 11.

If retirement system property is located within the boundaries of the system and is used by the system for the production of income then the property will be subject to an in-lieu fee as provided for under Government Code section 75101; i.e., a fee equal to the difference between the amount that would have accrued as real property secured taxes and the amount of possessory interest unsecured taxes paid for that property. The proper implementation of section 7510 as limited by the California Constitution article XIII A (Prop. 13) and article XIII, section 11 is as follows:

1. The in-lieu fee of section 7510 only applies to property located within its owner's boundaries. It does not apply to system property outside the system boundaries because such property "has not been removed from the secured roll" as required in section 7510 and because of the application of article XIII, section 11 to such property.
2. The value level to be used to measure the in-lieu fee for property located within the system boundaries is its market value as determined under California Constitution article XIII A (Prop. 13) and appropriate subsequent legislation just as it would be determined had the property been purchased by a non-government entity.
3. The total of property tax assessment and in-lieu fee against system properties purchased for income production shall be ascertained by first determining the possessory interest assessment to the private party occupants and then the section 7510 fee. When a retirement system purchases property for investment purposes, which property has tenants in occupancy, the calculation of the value of the tenant's interest should not be based on the market value of the property at the time of the purchase. The system would take the property subject to the lease(s). The leases would not change ownership until the new owner negotiated a renewal, sublease or assignment with the existing tenants or created new possessory interests. Since the tenant's interests have not changed ownership there is no basis for reappraising those interests. They


should be assessed at the value that they would have been assessed at had they been taxable possessory interests at the time of the system purchase.

Obviously, the retirement systems in-lieu fee will vary depending on the taxable value of the possessory interests and would be equivalent to taxes due on the fee value should the system purchase vacant property.

4. If system property is taxable when purchased and located outside the system's boundaries it shall be assessed as provided in California Constitution, article XIII, section 11(f) in such a way that the assessment of the remainder interest and the possessory interests shall not exceed a Proposition 13 assessment that would have been made had the purchase been a private sector purchase. Remember, property located outside the system's boundary, and thus subject to a section 11 assessment, is not subject to the in-lieu fee provided for in section 7510.

If the system purchases unimproved land, outside its boundaries, and then builds an income-producing structure, the land is subject to a section 11 assessment but the structure is not (see Art. XIII § 11). Section 7510 does not apply to either, since neither was removed from the roll (i.e., the land on the roll is not removed by reason of its assessment conversion to a section 11 assessment, and the structure, being new, was never on the roll). The property, land and structure, are subject only to section 11 assessment on the land and a possessory interest assessment on the property's tenants.

We recommend you disregard the provisions of Assessors' Letter 83/03 and the contents of Mr. James J. Delaney's memorandum of December 19, 1983, to the extent that either is inconsistent with the conclusions reached hereinabove. The discussion herein was reached after discussions with Mr. Delaney and with your division, so no useful purpose would be had by analyzing or commenting upon irrelevant portions of either Assessors' Letter 83/03 or Mr. Delaney's memorandum of December 19, 1983.


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cc: Mr. Richard H. Ochsner
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